Managing Your Company's Most Valuable Asset: ITS REPUTATION

By **Professor Charles Fombrun** and **Professor Cees van Riel**

Recent corporate scandals made household names out of Enron, WorldCom, Tyco, Adelphia, Arthur Andersen, Parmalat, Ahold, and Martha Stewart Living Omnimedia. They point to a fundamental flaw in late 20th century organisation models, models that promoted personal success, celebrity, and hubris over true leadership, and which also dramatically failed to serve the interests of employees, investors, customers, and the general public.

Responsible leaders are those who value their companies' reputations and manage them, effectively as rent-producing economic assets. Better managed companies have institutionalised a model of leadership that recognises the interests of multiple constituencies, values how well those constituencies are served, regularly monitors their perceptions, and expresses the company's values and beliefs abundantly, consistently, with authenticity and transparency. Leaders who systematically measure, value, and manage their companies' reputations have a better chance of surviving the risky, noisy, and contested environments in which 21st Century companies increasingly operate.

REPUTATIONS CAN BE MEASURED

A corporate reputation describes what people *think* and *feel* about a company based on information (or mis-information) they have been exposed to about its products, employees, social initiatives, past performance, or future prospects. Unfortunately, managers have had to deal with a variety of widely-publicised but inconsistent assessments that prevented systematic and reliable valuations of corporate reputations. To overcome this, we joined forces with the market research firm Harris Interactive in 1999 to develop and promote a standardised instrument that could be used to measure perceptions of companies across industries and stakeholder segments. The 'Reputation Quotient' (RQ) emerged and was developed as an 'open standard' for corporate reputation measurement around the world.

To develop a database for research, the Reputation Institute working with Harris Interactive and its market research partners, undertook a reputation measurement of the most visible companies in ten countries: Australia, Denmark, France, Germany, Italy, the Netherlands, Norway, Sweden, the United Kingdom, and the USA. In each country, we interviewed representative samples of the general public to understand the 'public reputations' of those companies (see overleaf). We expect to extend this research into another 5 countries by 2005.

REPUTATIONS CAN BE VALUED

Four approaches that estimate the financial value of a company's reputation concur with the suggestion that reputations are important economic assets. The value ranges are from 20% to 90% of a company's total market value.

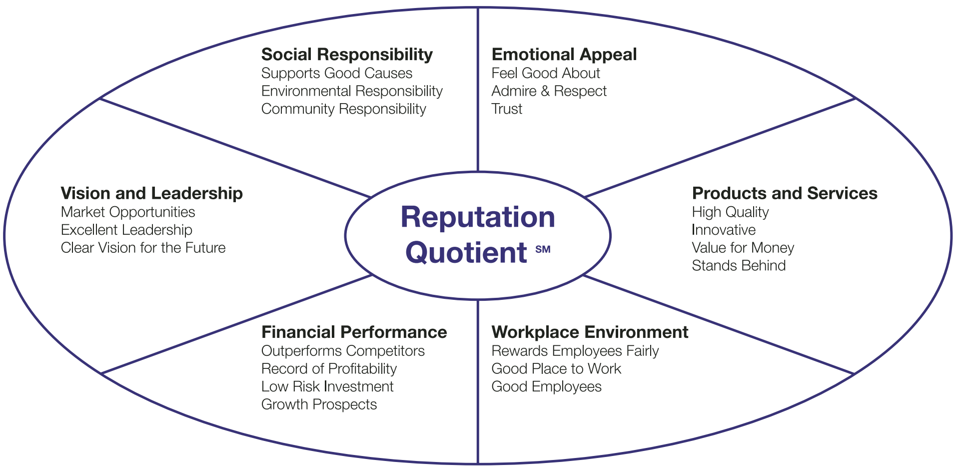
1. Losses from Crisis: Following a crisis, most companies lose reputation. The economic value of the reputation loss is the dissipated market value minus the expected clean-up and legal costs associated with the crisis. Over time, some companies recover dissipated value quickly and the crisis 'fizzles out'. Others experience more extended damage. Research suggests that the difference may lie in how the crisis is handled, and what the reputation of the company was beforehand. A 2001 study charted the impact of man-made catastrophes on the market values of 15 companies in the U.S. and abroad. They ranged from the first Tylenol tampering of 1982, to a Heineken recall due to rumours of broken glass in its beer bottles in 1993. On average, all 15 companies in the study took an initial hit of 8% off their market value. However, the companies quickly could be defined into two distinct groups,

THE ESSENCE OF REPUTATION BUILDING LIES, NOT IN POSTURING AND SPIN DOCTORING, BUT IN AUTHENTIC COMMUNICATION INTERNALLY AND EXTERNALLY TO STAKEHOLDERS

THE BUILDING BLOCKS OF CORPORATE REPUTATION

Research indicates that people assess companies on the basis of up to 20 attributes that can be classified in six dimensions. The 'Reputation Quotient' (or RQ) is an 'open standard' for measuring corporate reputations developed on the basis of these six dimensions and 20 attributes:

1. **Emotional Appeal:** How much the company is liked, admired, and respected.
2. **Products and Services:** Perceptions of the quality, innovation, value, and reliability of the company's products and services.
3. **Financial Performance:** Perceptions of the company's profitability, prospects, and 'riskiness'.
4. **Vision and Leadership:** Perceptions of the strength and depth of the company's vision and leadership, and its ability to take advantage of opportunities.
5. **Workplace Environment:** Perceptions that the company is good to work for, has high quality employees, and treats them fairly.
6. **Social Responsibility:** Perceptions of the company as a good citizen in its dealings with local communities and the environment.



PUBLIC PERCEPTIONS OF THE BEST AND WORST COMPANIES

RQ scores are used to benchmark the reputations of companies in different countries, across industries, and across stakeholder segments. The Studies examined public perceptions of the world's most visible companies in 6 countries using the RQ instrument. In the most recent surveys conducted by the Reputation Institute and its market research associates in Autumn 2003 and Spring 2004, the following companies were rated among the best and worst in each country by the general public:

Country	Company	Highest RQ	Company	Lowest RQ
Australia	Virgin Blue	80.7	AMP	58.2
Denmark	A.P. Moller-Maersk	84.4	McDonald's	63.4
Netherlands	Heineken	79.1	UPC	46.5
Norway	Tine	75	NSB	54.8
Sweden	IKEA	79.3	Skandia	34.0
USA	Johnson & Johnson	79.4	Enron	26.7

the 'recoverers' and 'non-recoverers'. The recoverers' shares sagged only 5% in the first weeks while the non-recoverers' shares lost 11%. After 10 weeks, the recoverers' shares actually rose 5% and stayed comfortably in the positive for the balance of the year. In contrast, the non-recoverers' shares stayed down and finished the year at a loss of 15%.

2. Accounting Values: Market values of companies differ significantly from the book values that accountants commonly tabulate. This is due principally to the non-capitalised value of a company's intangible assets – which includes its reputation. Intangible assets of large public companies in the U.S. and the U.K. have consistently risen in the last 40 years, from an estimated 51% of the company's market value in 1981 to as high as 85% in 2001.

3. Discounted Cash Flows: A more refined estimate of a company's reputational capital can be determined by how much a third party would be willing to pay to lease a corporate name? In fact, licensing arrangements are royalty rates for corporate names. The more a licensee is prepared to pay to rent a corporate name, the greater must be the drawing power of the company's name to customers and investors. Royalty percentages, on corporate licences, generally range between 5% and 15% of projected sales. An estimate of the value of a company's reputation is therefore the net present value of expected royalty payments from using the company's name over, say, 20 years.

4. Economic Premiums: Various academic teams have examined the linkages between corporate reputation, market value, book value, and the profitability of firms rated in Fortune's 'most admired companies' survey. After various adjustments, estimates of the relative value of a 15% difference in corporate reputation for a $3 billion company amounted to $500 million, suggesting that the company's reputation represents 20% of its market value.

STRONG REPUTATIONS RESULT WHEN COMPANIES OWN A DISTINCTIVE POSITION IN THE MINDS OF STAKEHOLDERS

Although measurements differ, clearly research confirms that reputations are valuable intangible assets. It's a safe bet from the significant valuations documented in these studies that reputations are worth a lot more than is currently being spent on managing them.

LEARNING FROM THE BEST-REGARDED COMPANIES

We recently examined how some of the best-rated companies in RQ surveys in four countries actually managed their reputations. Five principles emerged from studying those international companies. They suggest a leadership model of reputation management that links strategic positioning and brand marketing to organisation theory and corporate communications.

Principle 1: Be Distinctive

Strong reputations result when companies own a distinctive position in the minds of stakeholders. The U.S. health products group Johnson & Johnson (J&J) has consistently topped RQ ratings in the USA since 1999. This is no accident: trustworthiness is a focal point of all J&J's communications. Their promotions single-mindedly portray J&J as a nurturing and caring company, with babies and children invariably featured or mentioned, despite the fact that J&J's baby products division represents a small fraction of the company's portfolio of products and businesses. J&J owns a distinctive niche in the minds of consumers.

Principle 2: Be Visible

Strong reputations result when companies build visibility by focusing their actions and communications around a single theme, and express it over and over again. Top-rated Coca-Cola's products are ubiquitous, as is its world-famous logo. All of the company's communications portray a core 'devotion to the product' and its integral role as a beverage company devoted to quenching the thirst of consumers. Contrast that to archrival PepsiCo whose reputation is of the also-ran, seeking to leverage the visibility of the 'cola-wars' to chip away at its premium-priced, distinctively-branded nemesis. Coca-Cola's continued dominance of the beverage category is a testament to the advantage of visibility and focus in the design of reputation programmes.

Principle 3: Be Consistent

Strong reputations result when companies are consistent in their actions and communications across channels and stakeholder groups. General Motors tends to fare poorly in public RQ surveys conducted in the US because of its inconsistent communications across divisions and across stakeholder groups. In contrast, GM's Saturn division in the US and Opel division in Europe both regularly fare well because they are well known for building strong ties to both employees and customers. Particularly at Saturn, communications

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reflect an integrated mindset across stakeholder groups in which loyalty from one group is used to generate loyalty from the other.

Principle 4: Be Authentic

Strong reputations result when companies are authentic and genuine. Efforts to manipulate external images via advertising and public relations —and not in conjunction with a company's core identity – ultimately fail. We examined first hand Shell's ambitious efforts to rebuild corporate reputation following its mishandling of two major crises in 1995. The programme developed was rooted in a soul-searching process that required identifying the company's business principles and 'core purpose' — the values it supported and the behaviours it was willing to endorse. Through focus groups around the world, Shell employees and leaders came to define Shell's core purpose as "Helping to Make the Future a Better Place," and the platform became an anchor for many of the company's subsequent reputation-building initiatives and communications.

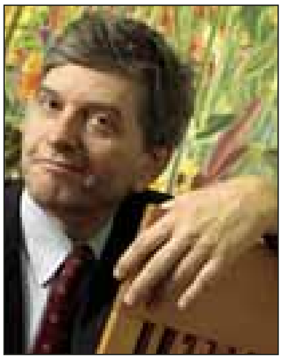
Principle 5: Be Transparent

Strong corporate reputations develop when companies are transparent in the way they conduct their affairs. Transparency requires communication in quantity and delivered in the spirit of 'full disclosure'. We found that the top-rated companies in most of the RQ surveys tended to disclose more information about themselves and seemed more willing to engage stakeholders in active dialogue. In the US, the controversial Sarbanes-Oxley Act challenged the historically cosy relationship between corporate management, their boards, accountants, and lawyers, and tasks companies with increased transparency in their communications with stakeholders. Following the executive scandal that put WorldCom into bankruptcy, the company not only changed its name back to MCI, but appointed a Chief Ethics Officer whose role is essentially that of ensuring consistency between actions and beliefs, reality and perceptions.

THE SCIENCE OF REPUTATION MANAGEMENT

Corporate reputations are strategic assets and a source of economic value for investors. Our research demonstrates that the essence of reputation building lies, not in posturing and spin doctoring, but authentic communication internally and externally to stakeholders. Reputation management is inherently about institutional leadership; It involves building competitive advantage from actively listening, communicating, and working with stakeholders to build approval and appeal. Doing so requires putting in place a continuous loop of measurement and valuation, providing the underpinnings of a scientific approach to reputation management. For companies and executives, it's nothing less than enlightened self-interest.

REPUTATIONS ARE IMPORTANT ECONOMIC ASSETS. THE VALUE RANGES ARE FROM 20% TO 90% OF A COMPANY'S TOTAL MARKET VALUE



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